



REPUBLIC OF THE PHILIPPINES
Supreme Court
Manila
FIRST DIVISION

June 30, 1987

G.R. No. L-47369

JOSEPH COCHINGYAN, JR. and JOSE K. VILLANUEVA, petitioners,
vs.
R & B SURETY AND INSURANCE COMPANY, INC., respondent.

FELICIANO, J.:

This case was certified to us by the Court of Appeals in its resolution dated 11 November 1977 as one involving only questions of law and, therefore, falling within the exclusive appellate jurisdiction of this Court under Section 17, Republic Act 296, as amended.

In November 1963, Pacific Agricultural Suppliers, Inc. (PAGRICO) applied for and was granted an increase in its line of credit from P400,000.00 to P800,000.00 (the "Principal Obligation"), with the Philippine National Bank (PNB). To secure PNB's approval, PAGRICO had to give a good and sufficient bond in the amount of P400,000.00, representing the increment in its line of credit, to secure its faithful compliance with the terms and conditions under which its line of credit was increased. In compliance with this requirement, PAGRICO submitted Surety Bond No. 4765, issued by the respondent R & B Surety and Insurance Co., Inc. (R & B Surety") in the specified amount in favor of the PNB. Under the terms of the Surety Bond, PAGRICO and R & B Surety bound themselves jointly and severally to comply with the "terms and conditions of the advance line [of credit] established by the [PNB]." PNB had the right under the Surety Bond to proceed directly against R & B Surety "without the necessity of first exhausting the assets" of the principal obligor, PAGRICO. The Surety Bond also provided that R & B Surety's liability was not to be limited to the principal sum of P400,000.00, but would also include "accrued interest" on the said amount "plus all expenses, charges or other legal costs incident to collection of the obligation [of R & B Surety]" under the Surety Bond.

In consideration of R & B Surety's issuance of the Surety Bond, two identical indemnity agreements were entered into with R & B Surety: (a) one agreement dated 23 December 1963 was executed by the Catholic Church Mart (CCM) and by petitioner Joseph Cochingyan, Jr, the latter signed not only as President of CCM but also in his personal and individual capacity; and (b) another agreement dated 24 December 1963 was executed by PAGRICO, Pacific Copra Export Inc. (PACOCO), Jose K. Villanueva and Liu Tua Ben Mr. Villanueva signed both as Manager of PAGRICO and in his personal and individual capacity; Mr. Liu signed both as President of PACOCO and in his individual and personal capacity.

Under both indemnity agreements, the indemnitors bound themselves jointly and severally to R & B Surety to pay an annual premium of P5,103.05 and "for the faithful compliance of the terms and conditions set forth in said SURETY BOND for a period beginning ... until the same is CANCELLED and/or DISCHARGED." The Indemnity Agreements further provided:

(b) INDEMNITY: — TO indemnify the SURETY COMPANY for any damage, prejudice, loss, costs, payments, advances and expenses of whatever kind and nature, including [of] attorney's fees, which the CORPORATION may, at any time, become liable for, sustain or incur as consequence of having executed the above mentioned Bond, its renewals, extensions or substitutions and said attorney's fees [shall] not be less than twenty [20%] per cent of the total amount claimed by the CORPORATION in each action, the

same to be due, demandable and payable, irrespective of whether the case is settled judicially or extrajudicially and whether the amount has been actually paid or not;

(c) MATURITY OF OUR OBLIGATIONS AS CONTRACTED HEREWITH: — The said indemnities will be paid to the CORPORATION as soon as demand is received from the Creditor or upon receipt of Court order or as soon as it becomes liable to make payment of any sum under the terms of the above-mentioned Bond, its renewals, extensions, modifications or substitutions, whether the said sum or sums or part thereof, have been actually paid or not.

We authorize the SURETY COMPANY, to accept in any case and at its entire discretion, from any of us, payments on account of the pending obligations, and to grant extension to any of us, to liquidate said obligations, without necessity of previous knowledge of [or] consent from the other obligors.

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(e) INCONTESTABILITY OF PAYMENTS MADE BY THE COMPANY. — Any payment or disbursement made by the SURETY COMPANY on account of the above-mentioned Bonds, its renewals, extensions or substitutions, either in the belief that the SURETY COMPANY was obligate[d] to make such payment or in the belief that said payment was necessary in order to avoid greater losses or obligations for which the SURETY COMPANY might be liable by virtue of the terms of the above-mentioned Bond, its renewals, extensions or substitutions, shall be final and will not be disputed by the undersigned, who jointly and severally bind themselves to indemnify the SURETY COMPANY of any and all such payments as stated in the preceding clauses.

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When PAGRICO failed to comply with its Principal Obligation to the PNB, the PNB demanded payment from R & B Surety of the sum of P400,000.00, the full amount of the Principal Obligation. R & B Surety made a series of payments to PNB by virtue of that demand totalling P70,000.00 evidenced by detailed vouchers and receipts.

R & B Surety in turn sent formal demand letters to petitioners Joseph Cochingyan, Jr. and Jose K. Villanueva for reimbursement of the payments made by it to the PNB and for a discharge of its liability to the PNB under the Surety Bond. When petitioners failed to heed its demands, R & B Surety brought suit against Joseph Cochingyan, Jr., Jose K. Villanueva and Liu Tua Ben in the Court of First Instance of Manila, praying principally that judgment be rendered:

b. Ordering defendants to pay jointly and severally, unto the plaintiff, the sum of P20,412.20 representing the unpaid premiums for Surety Bond No. 4765 from 1965 up to 1968, and the additional amount of P5,103.05 yearly until the Surety Bond No. 4765 is discharged, with interest thereon at the rate of 12% per annum; [and]

c. Ordering the defendants to pay jointly and severally, unto the plaintiff the sum of P400,000.00 representing the total amount of the Surety Bond No. 4765 with interest thereon at the rate of 12% per annum on the amount of P70,000.00 which had been paid to the Phil. National Bank already, the interest to begin from the month of September, 1966;

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Petitioner Joseph Cochingyan, Jr. in his answer maintained that the Indemnity Agreement he executed in favor of R & B Surety: (i) did not express the true intent of the parties thereto in that he had been asked by R & B Surety to execute the Indemnity Agreement merely in order to make it appear that R & B Surety had complied with the requirements of the PNB that credit lines be secured; (ii) was executed so that R & B Surety could show that it was complying with the regulations of the Insurance Commission concerning bonding companies; (iii) that R & B Surety had assured him that the execution of the agreement was a mere formality and that he was to be considered a stranger to the transaction between the PNB and R & B Surety; and (iv) that R & B Surety was estopped from enforcing the Indemnity Agreement as against him.

Petitioner Jose K. Villanueva claimed in his answer that. (i) he had executed the Indemnity Agreement in favor of R & B Surety only "for accommodation purposes" and that it did not express their true intention; (ii) that the Principal Obligation of PAGRICO to the PNB secured by the Surety Bond had already been assumed by CCM by virtue of a Trust Agreement entered into with the PNB, where CCM represented by Joseph Cochingyan, Jr. undertook to pay the Principal Obligation of PAGRICO to the PNB; (iii) that his obligation under the Indemnity Agreement was thereby extinguished by novation arising from the change of debtor under the Principal Obligation; and (iv) that the filing of the complaint was premature, considering that R & B Surety filed the case against him as indemnitor although the PNB had not yet proceeded against R & B Surety to enforce the latter's liability under the Surety Bond.

Petitioner Cochingyan, however, did not present any evidence at all to support his asserted defenses. Petitioner Villanueva did not submit any evidence either on his "accommodation" defense. The trial court was therefore constrained to decide the case on the basis alone of the terms of the Trust Agreement and other documents submitted in evidence.

In due time, the Court of First Instance of Manila, Branch 24 ¹ rendered a decision in favor of R & B Surety, the dispositive portion of which reads as follows;

Premises considered, judgment is hereby rendered: (a) ordering the defendants Joseph Cochingyan, Jr. and Jose K. Villanueva to pay, jointly and severally, unto the plaintiff the sum of 400,000.00, representing the total amount of their liability on Surety Bond No. 4765, and interest at the rate of 6% per annum on the following amounts:

On P14,000.00 from September 27, 1966;

On P4,000.00 from November 28, 1966;

On P4,000.00 from December 14, 1966;

On P4,000.00 from January 19, 1967;

On P8,000.00 from February 13, 1967;

On P4,000.00 from March 6, 1967;

On P8,000.00 from June 24, 1967;

On P8,000. 00 from September 14, 1967;

On P8,000.00 from November 28, 1967; and

On P8,000. 00 from February 26, 1968

until full payment; (b) ordering said defendants to pay, jointly and severally, unto the plaintiff the sum of P20,412.00 as the unpaid premiums for Surety Bond No. 4765, with legal interest thereon from the filing of plaintiff's complaint on August 1, 1968 until fully paid, and the further sum of P4,000.00 as and for attorney's fees and expenses of litigation which this Court deems just and equitable.

There being no showing the summons was duly served upon the defendant Liu Tua Ben who has filed no answer in this case, plaintiff's complaint is hereby dismissed as against defendant Liu Tua Ben without prejudice.

Costs against the defendants Joseph Cochingyan, Jr. and Jose K. Villanueva.

Not satisfied with the decision of the trial court, the petitioners took this appeal to the Court of Appeals which, as already noted, certified the case to us as one raising only questions of law.

The issues we must confront in this appeal are:

1. whether or not the Trust Agreement had extinguished, by novation, the obligation of R & B Surety to the PNB under the Surety Bond which, in turn, extinguished the obligations of the petitioners under the Indemnity Agreements;
2. whether the Trust Agreement extended the term of the Surety Bond so as to release petitioners from their obligation as indemnitors thereof as they did not give their consent to the execution of the Trust Agreement; and
3. whether or not the filing of this complaint was premature since the PNB had not yet filed a suit against R & B Surety for the forfeiture of its Surety Bond.

We address these issues *seriatim*.

1. The Trust Agreement referred to by both petitioners in their separate briefs, was executed on 28 December 1965 (two years after the Surety Bond and the Indemnity Agreements were executed) between: (1) Jose and Susana Cochingyan, Sr., doing business under the name and style of the Catholic Church Mart, represented by Joseph Cochingyan, Jr., as *Trustor[s]*; (2) Tomas Besa, a PNB official, as *Trustee*; and (3) the PNB as *beneficiary*. The Trust Agreement provided, in pertinent part, as follows:

WHEREAS, the TRUSTOR has guaranteed a bond in the amount of P400,000.00 issued by the R & B Surety and Insurance Co. (R & B) at the instance of Pacific Agricultural Suppliers, Inc. (PAGRICO) on

December 21, 1963, in favor of the BENEFICIARY in connection with the application of PAGRICO for an advance line of P400,000.00 to P800,000.00;

WHEREAS, the TRUSTOR has also guaranteed a bond issued by the Consolacion Insurance & Surety Co., Inc. (CONSOLACION) in the amount of P900,000.00 in favor of the BENEFICIARY to secure certain credit facilities extended by the BENEFICIARY to the Pacific Copra Export Co., Inc. (PACOCO);

WHEREAS, the PAGRICO *and the PACOCO have defaulted in the payment of their respective obligations in favor of the BENEFICIARY guaranteed by the bonds issued by the R & B and the CONSOLACION, respectively, and by reason of said default, the BENEFICIARY has demanded compliance by the R & B and the CONSOLACION of their respective obligations under the aforesaid bonds;*

WHEREAS, *the TRUSTOR is, therefore, bound to comply with his obligation under the indemnity agreements aforementioned executed by him in favor of R & B and the CONSOLACION, respectively and in order to forestall impending suits by the BENEFICIARY against said companies, he is willing as he hereby agrees to pay the obligations of said companies in favor of the BENEFICIARY in the total amount of P1,300,000 without interest from the net profits arising from the procurement of reparations consumer goods made thru the allocation of WARVETS; . . .*

I. TRUSTOR hereby constitutes and appoints Atty. TOMAS BESA as TRUSTEE for the purpose of paying to the BENEFICIARY Philippine National Bank in the manner stated hereunder, the obligations of the R & B under the R & B Bond No. G-4765 for P400,000.00 dated December 23, 1963, and of the CONSOLACION under The Consolacion Bond No. G-5938 of June 3, 1964 for P900,000.00 or the total amount of P1,300,000.00 without interest from the net profits arising from the procurement of reparations consumer goods under the Memorandum of Settlement and Deeds of Assignment of February 2, 1959 through the allocation of WARVETS;

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6. THE BENEFICIARY agrees to hold in abeyance any action to enforce its claims against R & B and CONSOLACION, subject of the bond mentioned above. In the meantime that this TRUST AGREEMENT is being implemented, the BENEFICIARY hereby agrees to forthwith reinstate the R & B and the CONSOLACION as among the companies duly accredited to do business with the BENEFICIARY and its branches, unless said companies have been blacklisted for reasons other than those relating to the obligations subject of the herein TRUST AGREEMENT;

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9. *This agreement shall not in any manner release the R & B and CONSOLACION from their respective liabilities under the bonds mentioned above.* (emphasis supplied)

There is no question that the Surety Bond has not been cancelled or fully discharged ² by payment of the Principal Obligation. Unless, therefore, the Surety Bond has been extinguished by another means, it must still subsist. And so must the supporting Indemnity Agreements. ³

We are unable to sustain petitioners' claim that the Surety Bond and their respective obligations under the Indemnity Agreements were extinguished by novation brought about by the subsequent execution of the Trust Agreement.

Novation is the extinguishment of an obligation by the substitution or change of the obligation by a subsequent one which terminates it, either by changing its object or principal conditions, or by substituting a new debtor in place of the old one, or by subrogating a third person to the rights of the creditor. ⁴ Novation through a change of the object or principal conditions of an existing obligation is referred to as objective (or real) novation. Novation by the change of either the person of the debtor or of the creditor is described as subjective (or personal) novation. Novation may also be both objective and subjective (mixed) at the same time. In both objective and subjective novation, a dual purpose is achieved—an obligation is extinguished and a new one is created in lieu thereof.⁵

If objective novation is to take place, it is imperative that the new obligation expressly declare that the old obligation is thereby extinguished, or that the new obligation be on every point incompatible with the old one. ⁶ Novation is never presumed: it must be established either by the discharge of the old debt by the express terms of the new agreement, or by the acts of the parties whose intention to dissolve the old obligation as a consideration of the emergence of the new one must be clearly discernible. ⁷

Again, if subjective novation by a change in the person of the debtor is to occur, it is not enough that the juridical relation between the parties to the original contract is extended to a third person. It is essential that the old debtor be released from the obligation, and the third person or new debtor take his place in the new relation. If the old

debtor is not released, no novation occurs and the third person who has assumed the obligation of the debtor becomes merely a co-debtor or surety or a co-surety.⁸

Applying the above principles to the instant case, it is at once evident that the Trust Agreement does not expressly terminate the obligation of R & B Surety under the Surety Bond. On the contrary, the Trust Agreement expressly provides for the continuing subsistence of that obligation by stipulating that "[the Trust Agreement] shall not in any manner release" R & B Surety from its obligation under the Surety Bond.

Neither can the petitioners anchor their defense on implied novation. Absent an unequivocal declaration of extinguishment of a pre-existing obligation, a showing of complete incompatibility between the old and the new obligation (and nothing else) would sustain a finding of novation by implication.⁹ But where, as in this case, the parties to the new obligation expressly recognize the continuing existence and validity of the old one, where, in other words, the parties expressly negated the lapsing of the old obligation, there can be no novation. The issue of implied novation is not reached at all.

What the trust agreement did was, at most, merely to bring in another person or persons-the Trustor[s]-to assume the same obligation that R & B Surety was bound to perform under the Surety Bond. It is not unusual in business for a stranger to a contract to assume obligations thereunder; a contract of suretyship or guarantee is the classical example. The precise legal effect is the increase of the number of persons liable to the obligee, and not the extinguishment of the liability of the first debtor.¹⁰ Thus, in *Magdalena Estates vs. Rodriguez*,¹¹ we held that:

[t]he mere fact that the creditor receives a guaranty or accepts payments from a third person who has agreed to assume the obligation, when there is no agreement that the first debtor shall be released from responsibility, does not constitute a novation, and the creditor can still enforce the obligation against the original debtor.

In the present case, we note that *the Trustor* under the Trust Agreement, the CCM, *was already previously bound to R & B Surety* under its Indemnity Agreement. Under the Trust Agreement, the Trustor also became *directly liable* to the PNB. So far as the PNB was concerned, the effect of the Trust Agreement was that where there had been only *two*, there would now be *three* obligors directly and solidarily bound in favor of the PNB: PAGRICO, R & B Surety and the Trustor. And the PNB could proceed against any of the three, in any order or sequence. Clearly, PNB never intended to release, and never did release, R & B Surety. Thus, R & B Surety, which was not a party to the Trust Agreement, could not have intended to release any of its own indemnitors simply because one of those indemnitors, the Trustor under the Trust Agreement, became also directly liable to the PNB.

2. We turn to the contention of petitioner Jose K. Villanueva that his obligation as indemnitor under the 24 December 1963 Indemnity Agreement with R & B Surety was extinguished when the PNB agreed in the Trust Agreement "to hold in abeyance any action to enforce its claims against R & B Surety .

The Indemnity Agreement speaks of the several indemnitors "apply[ing] jointly and severally (*in solidum*) to the R & B Surety] — to become SURETY upon a SURETY BOND demanded by and in favor of [PNB] in the sum of [P400,000.00] for the faithful compliance of the terms and conditions set forth in said SURETY BOND — ." This part of the Agreement suggests that the indemnitors (including the petitioners) would become co-sureties on the Security Bond in favor of PNB. The record, however, is bereft of any indication that the petitioners-indemnitors ever in fact became co-sureties of R & B Surety *vis-a-vis* the PNB. The petitioners, so far as the record goes, remained simply indemnitors bound to R & B Surety but not to PNB, such that PNB could not have directly demanded payment of the Principal Obligation from the petitioners. Thus, we do not see how Article 2079 of the Civil Code—which provides in part that "[a]n extension granted to the debtor by the creditor without the consent of the guarantor extinguishes the guaranty" could apply in the instant case.

The petitioner-indemnitors are, as, it were, second-tier parties so far as the PNB was concerned and any extension of time granted by PNB to any of the first-tier obligators (PAGRICO, R & B Surety and the trustors[s]) could not prejudice the second-tier parties.

There is no other reason why petitioner Villanueva's contention must fail. PNB's undertaking under the Trust Agreement "to hold in abeyance any action to enforce its claims" against R & B Surety did not extend the maturity of R & B Surety's obligation under the Surety Bond. The Principal Obligation had in fact already matured, along with that of R & B Surety, by the time the Trust Agreement was entered into. Petitioner's Obligation had in fact already matured, for those obligations were to mature "as soon as [R & B Surety] became liable to make payment of any sum under the terms of the [Surety Bond] — *whether the said sum or sums or part thereof have been actually paid or not.*" Thus, the situation was that precisely envisaged in Article 2079:

[t]he mere failure on the part of the creditor to demand payment after the debt has become due does not of itself constitute any extension of the referred to herein.(emphasis supplied)

The theory behind Article 2079 is that an extension of time given to the principal debtor by the creditor without the surety of his right to pay the creditor and to be immediately subrogated to the creditor's remedies against the principal debtor upon the original maturity date. The surety is said to be entitled to protect himself against the principal debtor upon the original maturity date. The surety is said to be entitled to protect himself against the contingency of the principal debtor or the indemnitors becoming insolvent during the extended period. The underlying rationale is not present in the instant case. As this Court has held,

merely delay or negligence in proceeding against the principal will not discharge a surety *unless there is between the creditor and the principal debtor a valid and binding agreement therefor, one which tends to prejudice [the surety] or to deprive it of the power of obtaining indemnity* by presenting a legal objection for the time, to the prosecution of an action on the original security.¹²

In the instant case, there was nothing to prevent the petitioners from tendering payment, if they were so minded, to PNB of the matured obligation on behalf of R & B Surety and thereupon becoming subrogated to such remedies as R & B Surety may have against PAGRICO.

3. The last issue can be disposed of quickly, Clauses (b) and (c) of the Indemnity Agreements (quoted above) allow R & B Surety to recover from petitioners even before R & B Surety shall have paid the PNB. We have previously held similar indemnity clauses to be enforceable and not violative of any public policy.¹³

The petitioners lose sight of the fact that the Indemnity Agreements are contracts of indemnification not only against actual loss but against *liability as well*.¹⁴ While in a contract of indemnity against loss as indemnitor will not be liable until the person to be indemnified makes payment or sustains loss, in a contract of indemnity *against liability*, as in this case, the *indemnitor's liability arises as soon as the liability of the person to be indemnified has arisen without regard to whether or not he has suffered actual loss*.¹⁵ Accordingly, R & B Surety was entitled to proceed against petitioners not only for the partial payments already made but for the full amount owed by PAGRICO to the PNB.

Summarizing, we hold that :

(1) The Surety Bond was not novated by the Trust Agreement. Both agreements can co-exist. The Trust Agreement merely furnished to PNB another party obligor to the Principal Obligation in addition to PAGRICO and R & B Surety.

(2) The undertaking of the PNB to "hold in abeyance any action to enforce its claim" against R & B Surety did not amount to an "extension granted to the debtor" without petitioner's consent so as to release petitioner's from their undertaking as indemnitors of R & B Surety under the INdemnity Agreements; and

(3) Petitioner's are indemnitors of R & B Surety against both payments to and liability for payments to the PNB. The present suit is therefore not premature despite the fact that the PNB has not instituted any action against R & B Surety for the collection of its matured obligation under the Surety Bond.

WHEREFORE, the petitioner's appeal is DENIED for the lack of merit and the decision of the trial court is AFFIRMED in toto. Costs against the petitioners.

SO ORDERED.

Yap (Chairman), Narvasa, Melencio-Herrera, Cruz, Gancayco and Sarmiento, JJ., concur.

Footnotes

¹ With then Judge Ricardo C. Puno presiding.

² R & B Surety had earlier made partial payments thereon to PNB.

³ Manila Surety & Fidelity Co. v. Villarama, 107 Phil. 891, 899 (1960).

⁴ De Cortes v. Venturanza, 79 SCRA 709, 722-23 (1977).

⁵ *Id* at 723.

⁶ Zapanta v. Rotaecche, 21 Phil. 154, 159 (1912).

⁷ E.g., Tui Siuco v. Habana, 45 Phil. 707, 713 (1924); Martinez v. Cavives, 25 Phil. 581 (1913).

⁸ Dungo v. Lopena, 6 SCRA 1007, 1015-16 (1962).

⁹ Guerrero v. Court of Appeals, 29 SCRA 791, 798 (1969).

¹⁰ Dungo v. Lopena, 6 SCRA 1007, at 1016 (1962).

¹¹ 18 SCRA 967, at 972 (1966).

¹² Bank of the Philippine Islands v. Albaladejo y Compania, 53 Phil. 141, at 145-146 (1929); underscoring supplied.

¹³ Security Bank v. Globe Assurance, 58 Off. Gaz. 3708 (30 April 1962); Cosmopolitan Insurance v. Reyes, 15 SCRA 258, 261 (1965); Alto Surety v. Aguilar, G.R. No. L-5625, March 16, 1954.

¹⁴ Guerrero v. Court of Appeals, 29 SCRA 791, 797 [1969], this case involves an indemnification clause similar to the INdemnity Agreements under consideration. See also Alto Surety & Insurance Co. v. Aguilar, L-5625, March 16, 1954.

¹⁵ Guerrero v. Court of Appeals, 29 SCRA 791 (1969); Associated Insurance & Surety Co. v. Chua, 7 SCRA 52, 54 (1963); Alto Surety & Insurance Co. v. Andan, 100 Phil. 403, 406 (1956).